

## **Tax Policy Notice: Refunds Due to Net Operating Loss Reduced**

The Job Creation and Worker Assistance Act of 2002, P.L. 107-147, allows an election to carry back a corporate net operating loss (“NOL”) five years, instead of the general two years, for federal income tax purposes. In response Senate Bill 1248 amended section 143.121 of Missouri’s income tax laws. It was effective June 19, 2002, and any amended Missouri return filed after that date reporting a change in federal taxable income attributable to an NOL that is being carried back more than two years must report such NOL amount as an addition to income.

An NOL allowed by Internal Revenue Code section 172 is deducted in the computation of federal taxable income. There is no Missouri NOL deduction; however, when an NOL is deducted on a federal income tax return it reduces federal taxable income. The reduced federal taxable income is the starting point for Missouri income tax. Thus, prior to SB 1248 the deduction of an NOL on a federal return reduced Missouri taxable income and the Missouri tax.

The substantive change to Missouri’s statutes provides that certain NOL amounts must be added back to income on the Missouri income tax return. An NOL that for federal income tax purposes is carried back one or two years or carried forward up to twenty years will reduce Missouri taxable income. However, an NOL that is carried back more than two years for federal income tax purposes must be added back to income on the Missouri return, and thus, will not reduce Missouri taxable income at any time.

For example, none of these NOLs would reduce Missouri taxable income for any year: an NOL due to a product liability loss that is solely carried back to the tenth prior year; an NOL due to a federal RAR adjustment that is solely carried back to the third prior year; an NOL due to a casualty or theft loss that is solely carried back to the third prior year; or an NOL due to a Presidentially declared disaster area by a taxpayer engaged in a farming business or a small business that is solely carried back to the third prior year.

An election to carry an NOL back only to the fifth prior year may result in an increased Missouri tax for the carry back year. A taxpayer who has an NOL for tax year 2002 may elect to carry the loss back to 1997 for federal income tax purposes. The taxpayer would file an amended 1997 federal return and include the NOL deduction. This usually results in a lower federal taxable income, a lower federal tax liability, and an overpayment of federal tax, which would be refunded to the taxpayer.

Pursuant to section 143.601, RSMo, such taxpayer must also file an amended 1997 Missouri income tax return to report the lower federal taxable income. The taxpayer would then include the amount of the NOL deduction as an addition to income on this amended 1997 Missouri return. The taxpayer would need to re-compute the taxpayer’s federal income tax deduction on this amended 1997 Missouri return because of the

taxpayer's lower federal tax liability for 1997. Nothing in the revenue laws allows the taxpayer to reduce Missouri taxable income on any Missouri return when an NOL is carried back more than two years.

There is a provision in the Internal Revenue Code that allows the taxpayer to opt out of the five-year carry back period if the taxpayer chooses to and exercises the election by November 1, 2002. Regardless, the starting point for Missouri income tax is federal taxable income.